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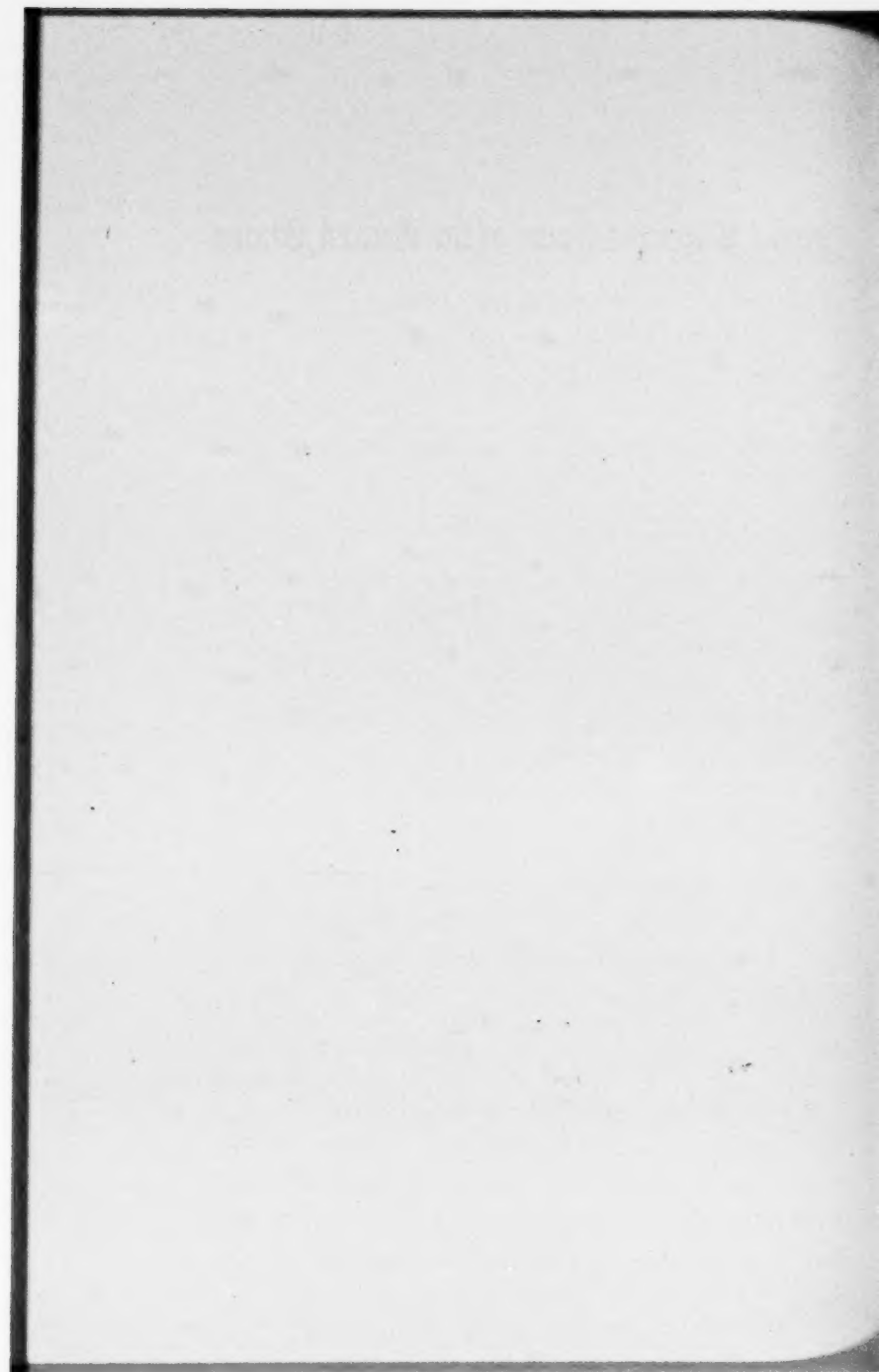
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(1)



In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 294

SOUTHEASTERN BUILDING CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States (R. 32-47) are reported in 3 T. C. 381. The opinion of the Circuit Court of Appeals (R. 72-76) is reported in 148 F. 2d 879.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 19, 1945, and the petition for rehearing was denied May 15, 1945. (R. 77, 81.) The petition for a writ of certiorari was filed on August 3, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the

Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer is entitled for the taxable year 1939 to a deduction for obsolescence under Section 23 (1) of the Internal Revenue Code, as amended by Section 121 (c) and (d) of the Revenue Act of 1942.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(1) *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

* * * * *

(26 U. S. C. 1940 ed., Sec. 23.)

Revenue Act of 1942, c. 619, 56 Stat. 798:

SEC. 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

* * * * *

(c) *Depreciation Deduction*.—The first sentence of section 23 (1) (relating to deduction for depreciation) is amended to read as follows:

“A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

“(1) of property used in the trade or business, or

“(2) of property held for the production of income.”

(d) *Taxable Years to Which Amendments Applicable.*—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938.

* * * * *

(26 U. S. C. 1940 ed., Supp. IV, sec. 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (1)–6. *Obsolescence.*—With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost or other basis at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be

sustained and cannot be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.

STATEMENT

The facts as found by the Tax Court may be summarized as follows (R. 33-38):

The taxpayer was incorporated under the laws of Georgia on December 10, 1932, and has its principal place of business in Atlanta, Georgia. (R. 33.)

On January 2, 1933, Bertelle G. Barbour conveyed a storage warehouse and the land on which it was situated to the taxpayer. This property had been leased to the Western Union Telegraph Company for a term of 20 years from January 1, 1924, to December 31, 1943. The total rental was \$340,000, or \$17,000 per annum. Subsequent to January 2, 1933, all rents were paid to the taxpayer. (R. 33-34, 35, 36.)

This warehouse was erected upon a site chosen by Western Union and according to plans and specifications which it approved. The building was one of four similar warehouses operated by that company in the United States, and is a two-story brick and concrete structure, 110 feet by 180 feet long, and covering about 38,500 square feet. Its basement is just large enough for a furnace and it has an elevator and sprinkler system. There is a loading platform outside the

building and facilities for the loading and unloading of trucks in front of the building. The first floor is built to carry almost unlimited loads, and the second floor will carry from 200 to 250 pounds to the square foot. It is built very substantially beyond the requirements of an ordinary storage warehouse. (R. 35-36.)

The building was occupied by Western Union from January 1, 1924, to July 1934, and was vacant from July, 1934, to January 1, 1935, but was then sublet by Western Union from February 1, 1935, to December 31, 1938, to Peaslee-Gaulbert Corporation, a Kentucky corporation. The taxpayer assented to this sublease on February 27, 1935. The total rent for this term of 47 months was \$22,100 (or \$5,685.11 per annum). On December 14, 1938, the taxpayer assented to a sublease by Western Union to Fulton County, Board of Public Welfare from January 1, 1939, to December 31, 1939, at the rental of \$4,800 for the term. On August 23, 1939, the taxpayer assented to a sublease from Western Union to Harbor Plywood Corporation, a Delaware corporation, for a term of four years from January 1, 1940, to December 31, 1943, at a rental of \$24,000 (or \$6,000 per annum). The last sublease and the lease to Western Union expired simultaneously on December 31, 1943. (R. 36.)

Western Union did not intend to renew its lease or reoccupy the building upon the expiration of

its lease, since the operations which it had been performing in this building were discontinued in Atlanta and consolidated with operations of a similar nature in Brooklyn. This fact was known to the taxpayer in July, 1934. (R. 36-37.)

Since the expiration of the lease on December 31, 1943, the taxpayer has not been able to find a tenant for these premises who has need of such extraordinary warehouse facilities. (R. 37.)

The cost of the building depreciated to July 1, 1934, was \$110,934.16; to January 1, 1939, \$97,184.87; to December 31, 1939, \$93,892.97; to December 31, 1943, \$80,725.32. The amount of depreciation allowed from July 1, 1934, to December 31, 1939, was \$16,941.68; and from December 31, 1939, to December 31, 1943, \$13,167.60. In 1939 the residual value, that is, the depreciated value of the building as an ordinary warehouse, was \$54,000, and on December 31, 1943, such value had increased to \$57,750. The fair rental value of this property as an ordinary warehouse was \$6,000 in 1939; and \$8,400 in 1943. (R. 37.)

The Tax Court held that the taxpayer was not entitled to any deduction on account of obsolescence for the taxable year 1939. (R. 41-47.) Accordingly it decided that there are deficiencies in income and excess profits taxes for 1939 in the amount of \$151.53 and \$66.18, respectively. (R. 47.)

The Circuit Court of Appeals affirmed the Tax Court's decision. (R. 76.)

ARGUMENT

This case does not present a conflict of decisions. It was correctly decided below, and does not call for further review.

Section 23 (1) of the Internal Revenue Code provides for "a reasonable allowance for obsolescence," and since 1924, Treasury Regulations¹ covering this and corresponding provisions of prior revenue statutes have continuously permitted a deduction for obsolescence with respect to physical property only when (Section 19.23 (1)-6, Treasury Regulations 103, *supra*)—

the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost or other basis at the end of its economic term of usefulness, * * *.

These regulations should be regarded as controlling. See *Real Estate Title Co. v. United*

¹ For provisions corresponding to those in Section 19.23 (1)-6 of Treasury Regulations 103, here involved see Article 166 of Treasury Regulations 65 and 69, promulgated under the Revenue Acts of 1924 and 1926, respectively; Article 206 of Treasury Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932, respectively; Article 23 (1)-6 of Treasury Regulations 86, 94 and 101, promulgated under the Revenue Acts of 1934, 1936 and 1938, respectively; and Section 29.23 (1)-6 of Treasury Regulations 111, issued in 1943 under the Internal Revenue Code.

States, 309 U. S. 13, 15-16; see also, *Becker v. Anheuser-Busch, Inc.*, 120 F. 2d 403, 413 (C. C. A. 8th), and *Detroit & Windsor Ferry Co. v. Woolworth*, 115 F. 2d 795, 797 (C. C. A. 6th). As petitioner failed to meet the requirements of these provisions, the deduction was properly denied below.

Petitioner not only ignores the regulation but is also in error as to the reasons given by the Circuit Court of Appeals and the Tax Court for their decisions. Both courts not only held, as petitioner asserts, that it had failed to show that the useful life of the warehouse was shortened by Western Union's failure to renew the lease but it was also their holding that petitioner had failed to show that deductions for depreciation, previously allowed and to be allowed, would be insufficient to restore the cost of the warehouse. (R. 44-6, 75.) Thus, both the Circuit Court of Appeals and the Tax Court recognized the necessity of meeting the two requirements set forth in the above regulation and found that the petitioner had not sustained its burden as to either. The Tax Court treated the question here as one of fact. (R. 45.) But, whether so treated or as a question of mixed law and fact (*Becker v. Anheuser-Busch, Inc.*, *supra*, p. 412), its decision should stand. The issue is largely a matter peculiarly within the province of the Tax Court; its ruling thereon is in accord with *Real Estate Title Co. v.*

United States, supra, and is supported by substantial evidence. Cf. *Dobson v. Commissioner*, 320 U. S. 489, 501-502, rehearing denied, 321 U. S. 231.

Petitioner asserts a conflict between this case and *U. S. Cartridge Co. v. United States*, 284 U. S. 511, and *Burnet v. Niagara Brewing Co.*, 282 U. S. 648. Both of those cases arose under the Revenue Act of 1918 and Article 161 of Treasury Regulations 45, which merely provided for a deduction for obsolescence. Thus, those cases did not involve or discuss the regulation which is applicable here and which was first issued in connection with the Revenue Act of 1924. However, it is clear from the reference to those cases in *Real Estate Title Co. v. United States, supra*, this Court did not consider the regulation to be in conflict with them and it is obviously not inconsistent with those decisions.

In *Burnet v. Niagara Brewing Co., supra*, it was held that the taxpayer, a brewery, was entitled to a deduction for obsolescence for 1918 and 1919 because of the advent of national prohibition on January 20, 1920. The evidence showed that it was known early in 1918 that prohibition would be put into effect; that the taxpayer completely abandoned parts of its brewery; that it could find no uses to which it could convert its buildings profitably; that after deducting the depreciation allowances for the taxable years, the book value

of the property was about three times the actual value; and that the company was dissolved in 1921. Thus, the useful economic life of the brewery was, for all practical purposes, brought to an end when prohibition went into effect and the deductions allowed for depreciation were wholly inadequate to cover the diminution in the brewery's value. Obviously, the circumstances of that case are very different from those here where the petitioner has failed to show that anything has occurred to shorten the useful life of its warehouse, and there has been no abandonment either of the building or of its so-called special purpose.

The facts in *U. S. Cartridge Co. v. United States, supra*, are also different. There obsolescence was allowed a taxpayer manufacturing ammunition because of the effect on its property of the cessation of World War I. To carry on this war-time business, the taxpayer had constructed buildings in 1914 on leased land under an agreement requiring it to surrender the buildings in 1924. Thus the physical life of the buildings, so far as the taxpayer was interested therein, continued to the end of 1924 but their useful or economic life, viewed also from its standpoint, lasted only until the end of the war when all orders for ammunition immediately ceased. Thereafter the taxpayer tried to operate, but such operations were small and unprofitable; its buildings could not be rented; and its attempt to man-

ufacture other articles resulted in a loss each year. Clearly, the cessation of the war suddenly brought the useful life of its property to an end, and the depreciation deductions were also wholly inadequate to recover the cost thereof. But we do not have a comparable situation here. The petitioner's building was constructed for a warehouse and nothing has occurred to prevent it from being used for such purpose; it was so used throughout the period of Western Union's lease and later. While the findings indicate that since the expiration of that lease on December 31, 1943, the petitioner has been unable to find a tenant for the premises who has need of such extraordinary warehouse facilities (R. 37), nevertheless since that time the property has been rented as a warehouse (R. 61). Furthermore, the Tax Court found that the fair rental value of this property as an ordinary warehouse was \$8,400 in 1943 which was more than 10% of its depreciated cost in that year. (R. 37.) Obviously the useful economic life of the warehouse has not been cut short and, as the Tax Court further found (R. 46), there has been no abandonment of the purpose for which it was built. Even if the property had been left vacant "more than non-use or disuse is necessary to establish" obsolescence. *Real Estate Title Co. v. United States*, *supra*, p. 16. See also, *Detroit & Windsor Ferry Co. v. Woodworth*, *supra*.

Petitioner, nevertheless, contends that obsolescence² should be allowed here because the failure of Western Union to renew its lease in 1943 resulted in a diminution of the value of its warehouse. However, the record not only fails to show that the alleged diminution has shortened the economic useful life of the warehouse, but there is also no evidence indicating that such diminution occurred in the taxable year 1939 nor the extent thereof, if any. The value of the warehouse was estimated as being less than its depreciated cost in that year but that may have been true for many years prior thereto. In addition such value has increased subsequent to that date since the record shows that it was higher in 1943 than in 1939. (R. 37, 62.) There is no showing that the cost of the warehouse will not be completely recovered through allowable deductions for depreciation. Thus, it is clear that there is no basis for obsolescence here.

² Petitioner refers to "extraordinary obsolescence" and indicated, in the court below, that such obsolescence is not covered by the regulation here. (R. 13.) In that connection it cites Bulletin "F", Bureau of Internal Revenue, Income Tax, Depreciation and Obsolescence, Estimated Useful Lives and Depreciation Rates (Revised January, 1942), but that bulletin neither amends nor affects the regulation. Instead, it merely explains that the Treasury Department includes normal obsolescence in its computation of a deduction for depreciation. Thus, deductions allowed as "obsolescence" are for what is usually classified as "extraordinary obsolescence." See Section 23.105, 4 Mertens, Law of Federal Income Taxation.

CONCLUSION

The decisions below are correct. There is no conflict. The petition for certiorari should be denied.

Respectfully submitted,

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SEPTEMBER, 1945.